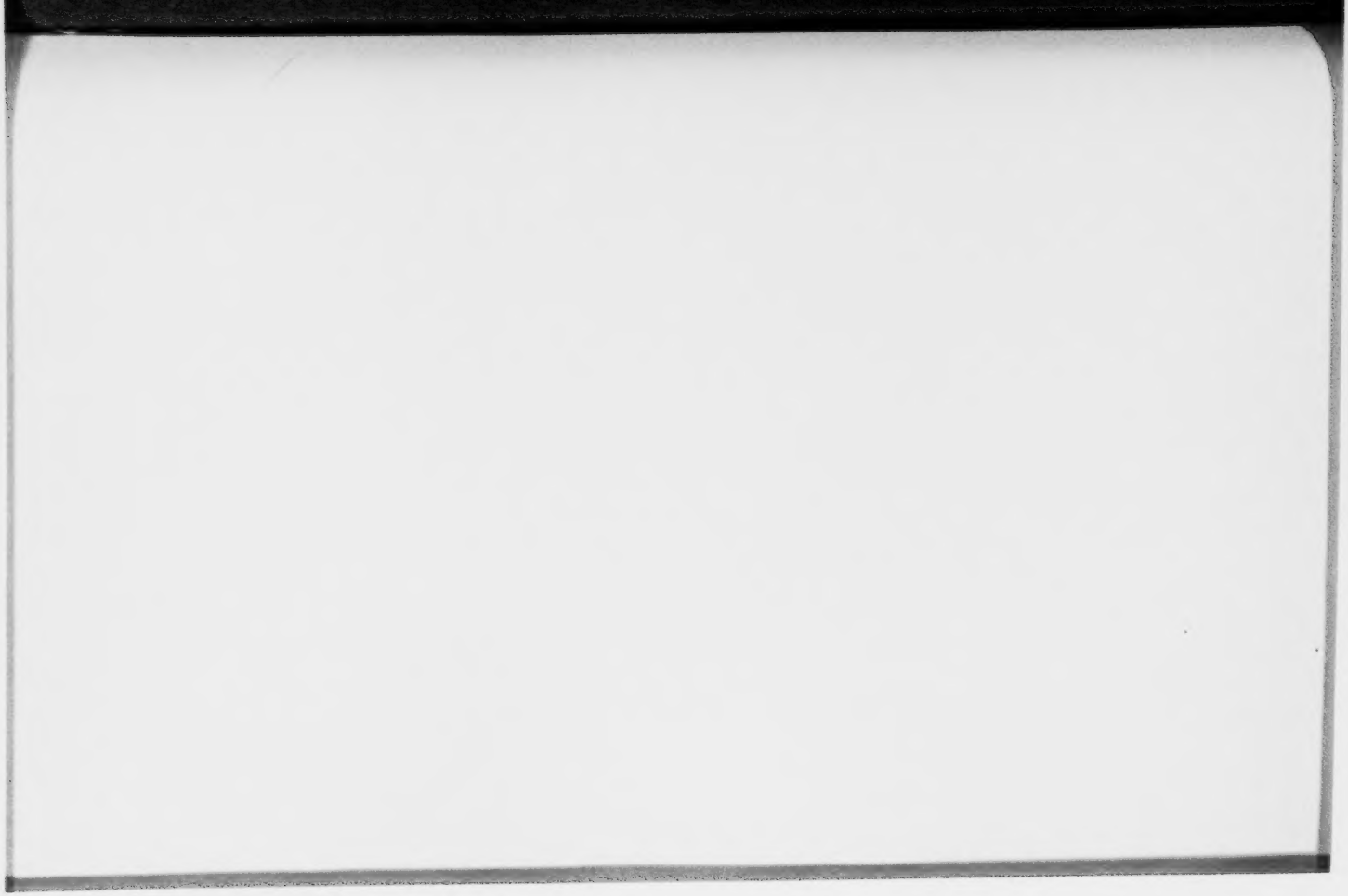

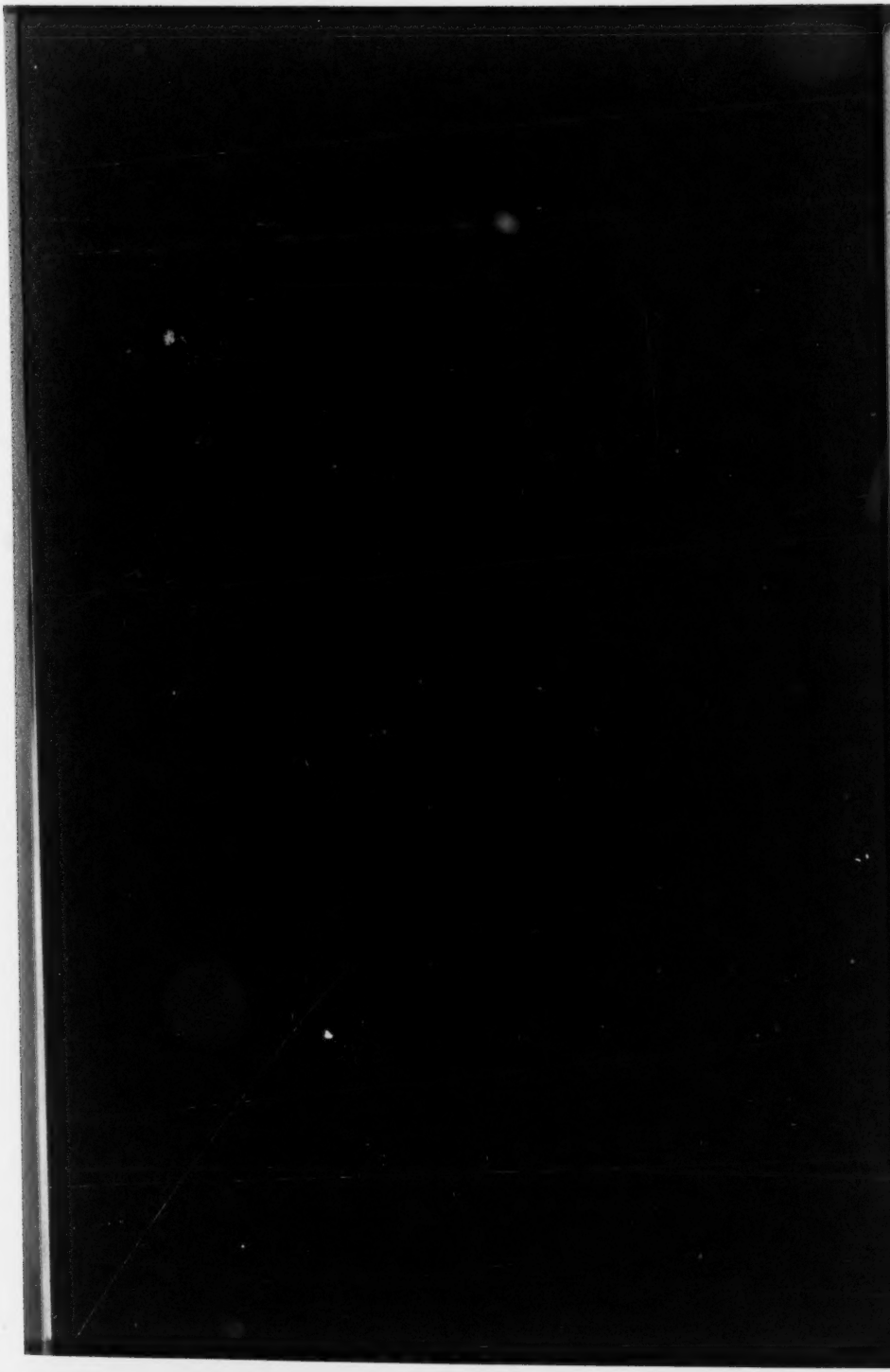

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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 985

KRESGE DEPARTMENT STORES, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 19–28) is reported in 44 B. T. A. 1210. The opinion of the United States Circuit Court of Appeals (R. 108–111) is reported in 134 F. 2d 76.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 12, 1943 (R. 111). The petition for rehearing was denied on March 17, 1943 (R. 120). The petition for a writ of

certiorari was filed on May 1, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer is a "personal holding company" within the terms of Section 351 (b) (1) (A) of the Revenue Act of 1934 because at least 80 per cent of its gross income for the taxable years was derived from dividends and interest. This depends upon whether certain amounts received by the taxpayer from a group of department stores in exact reimbursement for expenditures previously made by the taxpayer on behalf of the group of department stores constitute "gross income."

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved may be found in the Appendix, *infra,* pp. 11–13.

STATEMENT

The facts, as stipulated (R. 16–18) and as found by the Board of Tax Appeals (R. 20–24), may be summarized as follows:

The taxpayer is a Delaware corporation organized for the purpose of establishing one or more department stores and also to act as purchasing agent for domestic corporations (R. 20). It acquired all of the stock of several department stores in various cities; and in some instances

acquired part of the stock of department stores (R. 20–21).

For each of the fiscal years ended January 31, 1935, and January 31, 1936, more than 50 per cent in value of the taxpayer's stock was owned by not more than five individuals. During the taxable years involved the taxpayer did not own or operate a department store although, as previously stated, it did own stock in department store corporations. The taxpayer maintained in New York City a buying office which functioned for the direct benefit of four department stores, in three of which the taxpayer had stock.[1] (R. 21.)

The taxpayer, through its New York office, acted as buying agent for the various department stores which it served. In the great majority of cases, the taxpayer received purchase orders from those stores before it actually bought the goods. In these cases, the manufacturer or seller of goods purchased would invoice the proper department store directly for the goods so purchased. (R. 22.)

In some instances lots of merchandise of unusual value, in the judgment of the New York office, were purchased by the taxpayer without

[1] In one of those three, the taxpayer sold its stock to S. S. Kresge, who was a stockholder of the taxpayer (R. 21). The findings do not disclose whether S. S. Kresge similarly owned the stock in the fourth corporation, the Steinbach-Kresge store in Asbury Park, New Jersey (R. 21).

any previous request from any of the department stores it served. In such cases, invoices were made out to the taxpayer and the taxpayer re-invoiced the appropriate department store for the same at the same price; and passed on to the appropriate department store the discount allowed by the manufacturer or seller. (R. 22.)

In those instances where the manufacturers' or sellers' invoices ran to taxpayer, the shipping designation or direction to one of the department stores served was indicated or else the buying order indicated the designation of a particular department store (R. 22–23).

In addition to purchasing service, the New York office was on the alert for persons to fill executive positions in the stores the taxpayer was serving. This was done either with or without the request of any of such stores. Special attractions or exhibitions to draw persons into these stores were sought and obtained by the New York office and weak departments in the stores being served were surveyed and recommendations offered by the taxpayer through its New York office for their improvement. Taxpayer, through its New York office, consistently watched for new items, new departments, and special values in merchandise sold in the department stores it served through its New York office, and that office continually made recommendations about goods available for purchase

to those stores. Efforts were made to interest other stores in taxpayer's services and in a few instances these efforts were successful. (R. 23.)

The expenses of the New York purchasing office were totaled monthly, and once a month the various department stores which the taxpayer was serving were billed as follows: After deducting a fixed $100 per month payment to be made by the Steinbach-Kresge Company store at Asbury Park, New Jersey, the balance of the expenses was prorated among the other stores served by the taxpayer, according to the percentage which the annual sales of each such store bore to the total sales of all the stores for the prior year. (R. 23–24.)

The receipts and expenses of the New York City buying office of the taxpayer were thus equal (R. 24).

In its income tax return for 1935, the taxpayer reported total income of $156,429.18, including interest income in the amount of $93,889.98, and $61,720.73 as gross income received for services rendered by the New York office to the stores it thus served. In its return for 1936, it similarly reported total income of $96,277.05, including interest income in the amount of $63,406.45 and gross income in the sum of $32,759.48. (R. 24.) Thus, if the reimbursements for expenses which petitioner received from the stores it served were included in its gross income, petitioner would not

be a personal holding company under section 351 (b) (1) (A) because its income from dividends and interest would constitute less than 80% of its total gross income. The Board ruled that such reimbursements did constitute gross income and disapproved the Commissioner's determination of a deficiency based upon classifying petitioner as a personal holding company (R. 19–28). The court below, however, reversed the Board, holding that such receipts were not "gross income" (R. 107–111).

ARGUMENT

1. The decision of the court below is correct. Whether the taxpayer in this case comes within the statutory definition of a personal holding company depends upon whether the sums it received in exact reimbursement for expenditures previously made in behalf of certain department stores constituted gross income. The taxpayer entered into an informal arrangement (there was no written contract) whereby it maintained an office in New York and employed a number of people as buyers, whose duty it was to carry out specific buying orders for the various department stores in the group or to buy merchandise at advantageous prices which would be distributed among the group of stores and which would be billed to them without profit to the taxpayer and on the same terms granted to the taxpayer. The expenses of the taxpayer were prorated among

the department stores according to an agreed formula and were charged to the various department stores at the end of each month so that the taxpayer was reimbursed by the group of stores for the exact amount of its expenditures. Apparently expenses made in behalf of a particular store were billed to that store as service charges.

The Court below noted, adverting to the Board's findings, that the taxpayer was not a merchandising concern; neither was it in the business of performing services for compensation; rather it was a stockholding company and maintained the New York buying office solely for the purpose of increasing the value of its holdings (R. 110). The Board of Tax Appeals found that in a great majority of cases the taxpayer received purchase orders from the department stores before it actually bought the goods. In these cases the manufacturer or seller would invoice the proper department store directly for the goods so purchased. (R. 22.) The legal relationship between the taxpayer and the department stores in these instances would seem to be that of principal and agent. Therefore, whatever amounts the taxpayer spent as salaries for the buyers and clerks or as rent would seem to be the expenses of the principals, i. e., the department stores, not of the taxpayer. Since the taxpayer merely advanced money for its principals, reimbursement of those sums did not constitute income. See *All Russian Textile*

Syndicate, Inc. v. *Commissioner,* 62 F. 2d 614 (C. C. A. 2d), certiorari denied, 289 U. S. 752.

With respect to the other instances where the taxpayer bought merchandise without specific orders, but with the understanding that the stores would accept and pay for it without any profit to the taxpayer, we submit that the taxpayer acted as an agent with general powers, and that the relationship between the taxpayer and the department stores in those instances also was one of principal and agent. In the alternative we contend that when the taxpayer paid the expenses of the New York office, it was merely advancing funds for the various department stores in the group with the understanding that it would be repaid in the exact amount by the entire group of stores. Therefore, the sums received from the stores represented merely repayment of loans or advances.

The taxpayer maintains that the decision of the court below is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Wood* v. *Rasquin,* 97 F. 2d 1023, affirming *per curiam* 21 F. Supp. 211. In that case the taxpayer was a tenant in a co-operative apartment house and under the terms of the lease she was obliged to pay, in lieu of and as rent, her proportionate share of the aggregate amount of the cash requirements of the lessor for each year, including taxes and interest on the mortgage. She sought to deduct on her personal income tax re-

turn her share of the interest and her share of the taxes. The court held that only the lessor apartment house could deduct the interest and taxes, because the indebtedness for the taxes and interest was that of the lessor and not of the taxpayer. The facts of that case bear no resemblance to the facts of this case. No question was involved as to what constituted gross income; the question related to deductions. The court had no occasion to determine whether the rents received by the lessor constituted income because the lessor was not a party to the litigation.

The case of *Foley Securities Corp.* v. *Commissioner,* 106 F. 2d 731 (C. C. A. 8th), differs materially on its facts from the instant case.

2. Petitioner asserts a conflict (Pet. 6) with *Lane-Wells Co.* v. *Commissioner* (C. C. A. 9th), decided March 22, 1943, on the question whether the 25% penalty is applicable here by reason of petitioner's failure to file a personal holding company return on form 1120H. Although the *Lane-Wells* case held that the penalty cannot be imposed where the taxpayer, as here, has filed an ordinary corporation return on form 1120, the question is not presented by the decision of the court below. While it is true that the Commissioner originally asserted such a penalty (R. 10), the Board did not review the propriety of the penalty, for it had determined that the taxpayer was not a personal holding company. The court below merely re-

versed the Board on the question whether the taxpayer was a personal holding company; it did not pass upon the correctness of the penalty. The issue was neither discussed in any of the briefs filed in the court below, nor was it presented at the oral argument. The question will be open before the Board upon the determination of the petitioner's tax liability in accordance with the decision of the Circuit Court of Appeals.

If the decision of the Circuit Court of Appeals should be construed as approving the penalty, then this case would be, to that extent, in conflict with the *Lane-Wells* case, and certiorari would be appropriate, limited to that issue. But we think the issue was not passed upon by the court below and that there is no such conflict as calls for review by this Court.

CONCLUSION

The decision of the court below is correct and there is no conflict. The petition should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
HELEN R. CARLOSS,
MORTON K. ROTHSCHILD,
Special Assistants to the Attorney General.

MAY 1943.